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In the Supreme Court of the United States

OCTOBER TERM, 1948.

No. 280

THE LOCKE MACHINE COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF UPON PETITION FOR WRIT OF CERTIORARI.

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One would suppose from a reading of the Commissioner's brief opposing allowance of the writ that the question here is whether the taxpayer has justified as reasonable the sums it paid to the four individuals in question.

That is not this case.

The question here is:

1. Does the statute, properly read, bestow upon the Commissioner or the Tax Court, power to disallow part of a payment conceded to be compensation, on the ground the taxpayer paid too much?

   This question has never been passed upon by this or any other court. The question is one of first impression.

2. If the statute does bestow the power, has the issue whether the sums paid were reasonable been resolved by application of mistaken rules of law?

   Although compensation cases constitute the largest single class of litigation before the Tax Court, this Court has never had occasion to pass

upon the tests by which the power, if it exists, shall be controlled.

Once the Commissioner's extended effort to convert these—which are pure questions of law—into questions of fact, is put aside, it will be seen that his answer to the taxpayer's argument that the statute does not, and never was intended to, bestow the power the Commissioner has come to exercise thereunder, reduces to two points.

1. Argument Based upon Reenactment Cannot Give Act Meaning Words and History Deny.

The Commissioner's first reliance is the reenactment argument (Commissioner's brief, p. 7). The Commissioner having seized the power, Congress, having done nothing about it, is to be deemed to have approved. This is to "walk on quicksand," as the Court noted in *Helvering v. Hallock* (1940), 309 U. S. 106, 121.

The resort to presumed congressional approval would hardly seem enough to overbalance the teaching of the statute itself and its history (see petitioner's opening brief, pp. 12-18), as *Girouard v. United States* (1946), 328 U. S. 61, shows. Erroneous misconstruction, persevered in for no matter how long, cannot add to a statute what the Congress did not put there. This is the teaching of the cases. Recall for example:

Erie Railroad Co. v. Tompkins (1938), 304 U. S. 64, where, after nearly a hundred years and many sessions of the Congress, the Court gave to the statute there involved the meaning the Court was convinced Congress originally intended the statute to have.

Neirbo v. Bethlehem Shipbuilding Corp., Ltd. (1939), 308 U. S. 165, where a statute, which had survived nearly 100 years of repeated attempts at legislative change, was given a meaning the Court considered in harmony with the congressional intent.

City Bank Farmers Trust Co. v. Helvering (1941), 313 U. S. 121, where, although the statute had been reenacted 12 times, the Court rejected the construction put upon it by the Commissioner.

Here, it must be remembered, the question as to the meaning of the statute arises for the first time. The question comes unencumbered by any decision fixing upon the statute a meaning contrary to that disclosed by its history.

2. Where Sum Paid Is Admittedly Compensation Paid in Good Faith, Power to Disallow Ends.

The Commissioner's second point (Commissioner's brief, pp. 9, 11) is that, if petitioner's argument is sustained, then the taxpayer becomes the sole judge of the amount he may pay his employees.

Why not?

He is the "sole judge" of the amount in the case of every other business expense.[1]

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[1] The Commissioner hints, but does not expressly say (Commissioner's brief, p. 10, note 7), that other deductions are subject to the test of "reasonableness" as to amount. This is not so (see petitioner's opening brief, p. 17, note 7). In *Commissioner v. Flowers* (1946), 326 U. S. 465, relied upon by the Commissioner, the traveling expense was not disallowed because it was unreasonable in amount; it was disallowed because it was a class or kind of expenditure which was not allowable under the statute. The case lends no support to the doctrine that the Commissioner could object to the payment of $4.03 for a lower berth when an upper could be had for $2.99. And yet that is precisely the kind of power the Commissioner claims to exercise when he says, as to Otto Gammel for example, that the taxpayer should have paid him, a certified public accountant devoting his full time to the taxpayer's business, only $3,500.

Limericks, Inc. v. Commissioner (5 C. C. A., 1948), 165 F. (2d) 483, also relied upon by the Commissioner, is likewise a different case. There, the Tax Court, having held that payments masquerading (7 T. C. 1129, at 1136) "under the designation of rent were in truth and in fact distributions of dividends," disallowed them, and the reviewing court affirmed. The question, said the reviewing court, was whether amounts paid as rent (165 F. (2d) 483, at 484) "constituted in reality a distribution of profits."

The Commissioner can, of course, always challenge a payment if it is not what it purports to be. But that is not this case. Here it is conceded that what the taxpayer paid was compensation. It was disallowed solely on the ground that the taxpayer paid too much—even though fixed pursuant to a plan going back ten years.

Nor does the requirement that only "ordinary and necessary" expenses (Commissioner's brief, pp. 9, 11) are allowable affect this case. As Dean Griswold has pointed out, 56 HARVARD LAW REVIEW 1142, 1145:

> "It is true that the expenses must be 'ordinary and necessary,' but these words are given full and adequate function when they are used to separate capital expenditures from current expenses, on the one hand, and when they eliminate such things as illegal expenditures or wholly unrelated expenses, on the other."

CONCLUSION.

If the taxpayer's reading of the statute is correct—and the Commissioner advances nothing to prove it wrong—then there has been a seizure of enormous power by the Commissioner. A power so vast should not pass by default.

The question is of obvious importance.

It should have the attention of this Court.

The writ should issue.

Respectfully submitted,

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